[COMMITTEE PRINT]

DESCRIPTION OF BILLS

RELATING TO

CIGARETTE TAXATION AND CIGARETTE SMUGGLING

LISTED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON MISCELLANEOUS REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS

ON MARCH 21, 1978

PREPARED FOR THE USE OF THE

COMMITTEE ON WAYS AND MEANS

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

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I. Summary

This pamphlet discusses the background of the cigarette smuggling problem, its consequences, the solutions that have been proposed to deal with it, the specific features of the bills scheduled for a hearing before the Ways and Means Subcommittee on Miscellaneous Revenue Matters on March 21, 1978, and the revenue impact of the bills.

Cigarette smuggling has become a serious problem since 1965 because of the increase in the interstate differential in State cigarette taxes. Cigarettes are relatively easy to smuggle and States have not been able to prevent smuggling in part because of the interstate nature of the problem and the fact that it is not a Federal offense. The loss in State cigarette tax and State sales tax revenue is estimated to be about $400 million a year. The profit in cigarette smuggling has, according to various governmental agencies and officials, encouraged a significant involvement by organized crime. Statements from State and Federal officials indicate that the smuggling problem is expected to become more serious if no action is taken.

In the past, some Federal and State actions have been taken, but these have not been very effective in reducing cigarette smuggling. In recent years there have been recommendations from various governmental agencies to make cigarette smuggling a Federal crime and provide Federal enforcement. Some experts have estimated that this would reduce smuggling at most by only 30 percent. Some of these groups, therefore, have also proposed solutions to deal directly with the cause of smuggling—that is, the interstate differential in State cigarette taxes. These proposals are to eliminate the interstate tax differential by substantially increasing the Federal cigarette tax of 8 cents a pack and distributing all or most of the proceeds to the States.

In testimony before the Subcommittee on Crime of the House Judiciary Committee on February 28 and March 8, 1978, several groups restated their support of one or the other (or both) of these approaches. The proposed solutions included in the bills scheduled for the hearing before the subcommittee are of two types: contraband and tax equalization.

The contraband approach makes possession or transportation of cigarettes on which the applicable tax has not been paid a Federal crime and punishable by a fine of $10,000 and 2 years in jail.

The tax equalization approaches are of two general types—represented by H.R. 10066 (Mr. Drinan and others) and H.R. 11152 (Mr. Jones of Oklahoma and others). The former is both a contraband and a tax equalization bill in which the Federal cigarette tax would be increased by 23 cents a pack and funds would be distributed to States which do not impose a cigarette tax in proportion to their cigarette sales. This distribution method results in a substantial increase in revenue for the low-tax States but returns the tax increase to the State from which it was obtained.

The other bill, H.R. 11152, would increase the Federal tax by 14 cents a pack and return most of the money to the States which elect to participate and reduce their State taxes to no more than 3 cents a pack and eliminate city cigarette taxes. The payment would be made in two parts: (1) a "hold harmless" payment to replace the tax revenue the States give up; and (2) an "additional revenue" payment equal to one-half the remaining revenue from the 14-cent tax increase distributed in proportion to cigarette sales (with the other half to go into the general fund of the Treasury). Any future increase in the Federal tax would be divided the same way, one-half to the States and one-half to the Treasury. The distribution is weighted to the high-tax States because of the "hold harmless" payment, but the "additional payment" based on actual cigarette sales moves the distribution in favor of the low-tax States.

The pamphlet further discusses some of the concerns that have been expressed with respect to the contraband and tax equalization approaches. There are two main criticisms that have been made of the contraband approach. First, it is said to involve excessive Federal interference in a State tax matter that the States have not themselves vigorously pursued. Second, it is argued that it would be ineffective. The tax equalization approach has been criticized partly on the same grounds, that of excessive Federal interference in a State tax matter. It has also been criticized as increasing overall cigarette taxes too much, with adverse impact both on consumers and on the tobacco industry. H.R. 11152 has been criticized as being too redistributive, as it would raise more tax in most States than it would return to those same States. Further, the tax equalization approach has been criticized as foreclosing a source of additional revenue for the States by preventing any future State cigarette tax increases.

Finally, the pamphlet discusses some additional considerations: the possibility of having a State cigarette tax as a credit against the Federal tax; ways to avoid foreclosing future State cigarette tax increases; and consideration of a mandatory passthrough of Federal distribution of funds from possible increased Federal cigarette tax revenues to cities which give up their cigarette taxes.

II. Background on the Cigarette Smuggling Problem

ACIR Report

The Advisory Commission on Intergovernmental Relations (ACIR) has summarized the nature of the cigarette smuggling problem and the possible consequences of no action in its report, *Cigarette Bootlegging: A State and Federal Responsibility* (May 1977).[1] In the findings and recommendations section, the ACIR stated (*Report, p. 1*):

> Cigarette bootlegging is a tax administration problem that has developed since 1965. Tax evasion, resulting from the transportation of cigarettes from low-tax States for sale in high-tax States, has been described by the Federation of Tax Administrators, "to be among the most troublesome in the entire State tax field."
>
> There are six basic reasons why the States have had difficulty in controlling cigarette bootlegging:
>
> 1. Cigarettes are relatively easy to handle and transport and smuggling them across open borders is difficult to detect.
> 2. Penalties for cigarette bootlegging are generally light and are not an effective deterrent to bootleggers.
> 3. Cigarette bootlegging is not a Federal offense and the interstate nature of the problem hampers State and local law enforcement efforts.
> 4. Potential profits in cigarette bootlegging are so great that a wide variety of people are attracted to this illegal activity.
> 5. Because of the high profit potential, organized crime has become heavily involved in bootlegging.
> 6. Cigarette smuggling is a law enforcement problem and most tax administrators are not equipped to handle this type of problem.

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[1] Hereinafter referred to as *Report*. The Advisory Commission on Intergovernmental Relations (ACIR) was created by the Congress in 1959 to monitor the operation of the American federal system and to recommend improvements. ACIR is a permanent national bipartisan body representing the executive and legislative branches of Federal, state, and local government and the public.

The Commission is composed of 26 members—nine representing the Federal government, 14 representing State and local government, and three representing the public. The President appoints 20—three private citizens and three Federal executive officials directly and four governors, three state legislators, four mayors, and three elected county officials from states nominated by the National Governors' Conference, the Council of State Governments, the National League of Cities, U.S. Conference of Mayors, and the National Association of Counties. The three Senators are chosen by the President of the Senate and the three Congressmen by the Speaker of the House.

Each Commission member serves a two-year term and may be reappointed.

The ACIR *Report* continued (pp. 1 and 2):

The basic cause of cigarette smuggling is the disparity in State tax rates. (See Map 1.) Tax rates range from 2 cents in North Carolina to 21 cents in Massachusetts and Connecticut, and 23 cents in New York City. The tax rate disparity between New York City and North Carolina translates to a difference in price of $2.10 per carton, which provides a highly attractive profit opportunity and invites criminal activity.

In 1965, the range in tax rates was from zero to 11 cents and the profit incentive for smuggling was much less. Today, after a decade of fiscal pressures and the cigarette-smoking health scare, many States have very high cigarette tax rates compared with tobacco-producing States, where rates have been kept relatively low. The resulting tax disparities have spurred bootlegging activity, particularly organized smuggling. Casual smuggling has existed for years, and although of concern to State tax officials, its financial and other consequences pose less of a problem to society than does organized smuggling.

The most visible consequence of cigarette smuggling is the revenue loss to State and local governments in high-tax States—about $391 million each year. This revenue loss is the main reason State tax administrators have become so concerned about the problem in recent years. The consequences of cigarette smuggling, however, extend beyond the loss of government revenues: taxpayers pay higher taxes or receive fewer services, cigarette wholesalers and retailers are driven out of business and jobs are lost, political and law enforcement officials are corrupted, trucks are hijacked and warehouses raided, and people are injured and even killed.[2]

[2] The ACIR commented further in its *Report*, (p. 21):

"In a nine-State area in the Northeast, the mob, including crime families from New England, Illinois, and Pennsylvania, bootlegs more than a billion packs annually, which creates profits for the mob of more than $105 million and losses to wholesalers and State tax bureaus of more than $500 million.

"Because of the huge inroads made by La Cosa Nostra smugglers, more than 2,500 drivers, packers, and salesmen in New York State have lost their jobs and nearly half of New York's legitimate wholesalers have folded. The remaining wholesalers are forced to pay $600,000 annually for skyrocketing insurance premiums and guards."

Also, the ACIR stated (*Report*, p. 2):

> On the surface, the solution to this problem appears simple: reduce or eliminate State tax differentials and bootlegging will disappear. Although true, achieving this solution is far from simple. Many States are relatively unaffected by smuggling and nine States (Indiana, Kentucky, New Hampshire, North Carolina, Oregon, South Carolina, Vermont, Virginia, and Wyoming) receive substantial benefits from cigarette smuggling. Some officials in these low-tax States contend that high-tax States have created the problem by levying unreasonably high cigarette taxes, and they can solve the problem by reducing their tax rates.
>
> Many high-tax States have fiscal problems and are not in a position, fiscally or politically, to reduce cigarette tax rates. The response of these States has been to urge the Federal Government to enact legislation prohibiting the transportation of contraband cigarettes in interstate commerce, a position supported by most States.
>
> A number of cigarette tax experts believe that a uniform tax rate is the only solution. However, there are massive political barriers to the enactment of uniform rates by the States.
>
> In the absence of uniform rates, law enforcement approaches to deal with this problem should be undertaken. A continued lack of strong action could result in a number of serious consequences:
>
> 1. Cigarette bootlegging will continue unabated and will increase if tax differentials increase further.
> 2. State and local government use of the cigarette tax as a revenue raising option will be limited. The reduction in the number of tax increases in the past 2 or 3 years indicates that this outcome may already be happening.
> 3. Organized crime will continue to reap large profits, which can be used to finance other illegal activities.
> 4. Tobacco wholesalers and retailers in many States will continue to suffer reduced sales and profits.
> 5. Taxpayers in States suffering revenue losses due to bootlegging will continue to pay higher taxes (cigarette or others) or receive a lower level of services.
> 6. Failure of State and Federal officials to take strong action to solve this problem could encourage bootleggers and discourage law enforcement officials.

Further, the ACIR commented (*Report*, p. 2):

> It must be conceded, however, that some experts question whether increased law enforcement activity on the part of the States or the Federal Government can reduce cigarette smuggling to an acceptable level.

State Cigarette Tax Rates

An overview of the geographic pattern of State cigarette tax rate differences and estimated revenue losses from cigarette smuggling is provided by Map 1.

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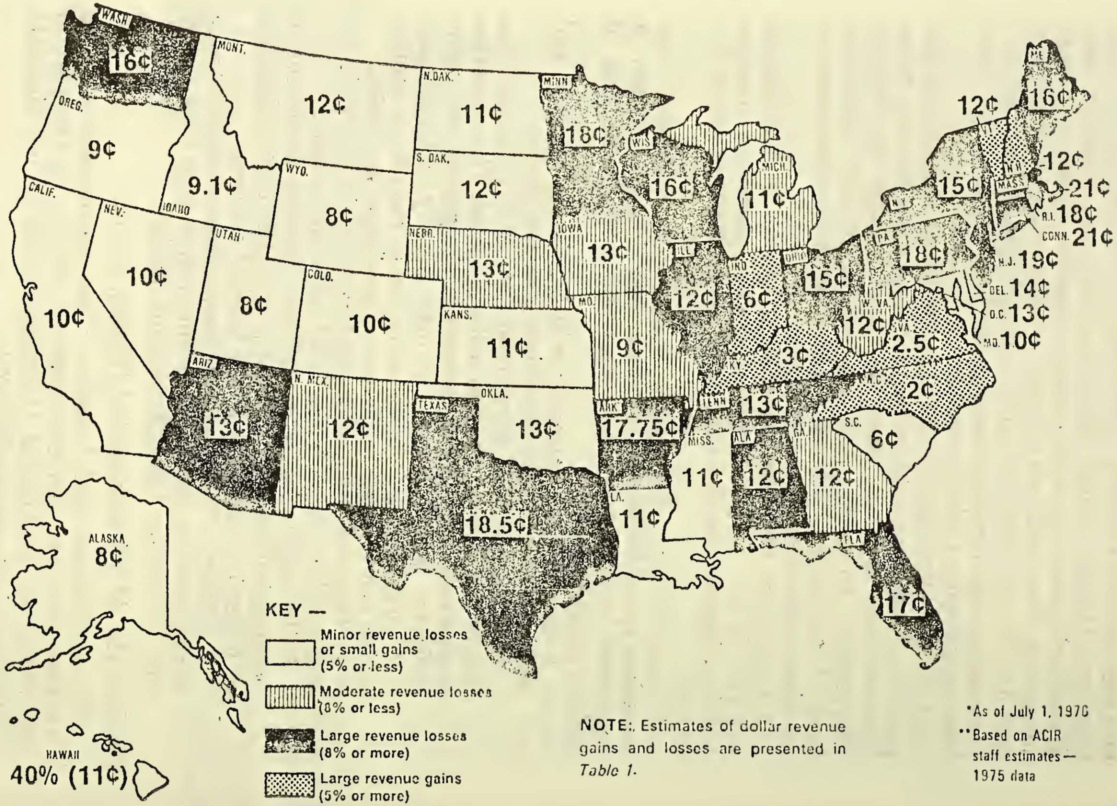
Map 1.—State Cigarette Tax Rates * and Cigarette Smuggling Revenue Gains and Losses **



A more detailed analysis is provided by table 1 which groups the States by the degree of their estimated revenue loss due to cigarette smuggling. The table shows the fiscal year 1977 cigarette tax receipts (col. 1), the estimated receipts without smuggling (col. 2), the revenue gain or loss from smuggling (col. 3), and this gain or loss from smuggling as a percent of actual revenues (col. 4). As indicated in table 1, 14 States have a serious cigarette smuggling problem, 9 have a moderate problem, 19 have a minor or no problem, and 9 benefit from tax evasion in other States.[3] This table is an updated version of the ACIR table which was based on 1975 data. It shows that the revenue loss from cigarette taxes only from smuggling to the *losing State* was an estimated $356 million at fiscal year 1977 levels. When the loss from State sales taxes is taken into account, the total revenue loss is about $400 million.

This estimate does not include the loss of Federal income tax revenue from the transfer or wholesaling, etc., of cigarettes from the legal to the *illegal area* where income is not reported for tax purposes.

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[3] This classification system is taken from the *Report*, table 10, pp. 30 and 31.

Table 1.—Estimated State Cigarette Tax Gain or Loss from Smuggling for States Classified by Degree of Tax Evasion Problem, Estimated Fiscal Year 1977*

(Dollar amounts in millions)

States	(1) State cigarette tax receipts: Actual (FY 77)	(2) State cigarette tax receipts: Without smuggling (est.)	(3) Tax gain or loss from smuggling [(2)−(1)]	(4) Tax gain or loss as a percent of actual FY 1977 receipts [(3)÷(1)]
U.S. total	$3,483	$3,805	[1] ($322)	(9.2)
Serious smuggling problem—14				
Arkansas	44.1	51.1	(7.0)	(15.9)
Connecticut	76.0	91.2	(15.2)	(20.0)
Florida	187.0	[2] 219.7	(32.7)	(17.5)
Illinois	178.5	196.0	(17.5)	(9.8)
Massachusetts	143.2	157.4	(14.2)	(9.9)
Minnesota	82.0	94.2	(12.2)	(14.9)
New Jersey	168.8	194.6	(25.8)	(15.3)
New York	336.1	394.6	(58.5)	(17.4)
Ohio	197.8	214.4	(16.6)	(8.4)
Pennsylvania	247.9	281.5	(33.6)	(13.6)
Tennessee	66.7	73.4	(6.7)	(10.0)
Texas	276.1	323.9	(47.8)	(17.3)
Washington	56.8	67.5	(10.7)	(18.8)
Wisconsin	84.6	96.6	(12.0)	(14.2)
Moderate problem—9				
Alabama	47.6	52.7	(5.1)	(10.7)
Arizona	35.0	38.3	(3.3)	(9.4)
Georgia	73.6	76.1	(2.5)	(3.4)
Maine	24.3	26.8	(2.5)	(10.3)
Michigan	139.1	145.1	(6.0)	(4.3)
Missouri	59.4	63.0	(3.6)	(6.1)
Nebraska	22.6	24.0	(1.4)	(6.2)
New Mexico	13.9	14.7	(.8)	(5.8)
West Virginia	28.1	29.7	(1.6)	(5.7)
Minor or no problem—19				
Alaska	4.8	4.6	.2	4.2
California	269.7	281.6	(11.9)	(4.4)
Colorado	32.7	[2] 32.1	.6	1.8
Delaware	12.2	12.4	(.2)	(1.6)
District of Columbia	12.4	12.2	.2	1.6
Kansas	31.4	32.8	(1.4)	(4.4)
Hawaii	9.3	9.3		
Idaho	9.0	8.7	.3	3.3
Iowa	45.5	48.7	(3.2)	(7.0)
Louisiana	55.6	57.5	(1.9)	(3.4)
Maryland	54.4	54.2	.2	.4
Mississippi	29.0	30.0	(1.0)	(3.4)
Montana	11.1	11.4	(.3)	(2.7)
Nevada	11.0	10.7	.3	2.7
North Dakota	8.4	8.6	(.2)	(2.4)
Oklahoma	48.5	49.8	(1.3)	(2.7)
Rhode Island	24.4	24.8	(.4)	(1.6)
South Dakota	9.0	9.1	(.1)	(1.1)
Utah	7.4	7.2	.2	2.7

Table 1.—Estimated State Cigarette Tax Gain or Loss from Smuggling for States Classified by Degree of Tax Evasion Problem, Estimated Fiscal Year 1977*—Continued

(Dollar amounts in millions)

	(1)	(2)	(3)	(4)
	State cigarette tax receipts			
States	Actual (FY 77)	Without smuggling (est.)	Tax gain or loss from smuggling [(2)−(1)]	Tax gain or loss as a percent of actual FY 1977 receipts [(3)÷(1)]
Beneficiaries of tax evasion in other States—9				
Indiana	52. 8	[2] 49. 6	3. 2	6. 1
Kentucky	22. 3	14. 5	7. 8	35. 0
New Hampshire	26. 8	14. 3	12. 5	46. 6
North Carolina	20. 3	13. 4	6. 9	34. 0
Oregon	32. 0	30. 4	1. 6	5. 0
South Carolina	22. 3	21. 3	1. 0	4. 5
Vermont	9. 4	8. 4	1. 0	10. 6
Virginia	17. 8	16. 9	. 9	5. 0
Wyoming	4. 7	4. 5	. 2	4. 2

*Note: Does not include sales tax loss.

[1] Losses exceed gains because the loss to the high tax States is greater than the gain to the low tax States. The smugglers and their customers share the difference. The loss to the losing States is estimated to be $356 million from the cigarette tax alone and when the loss of State sales tax revenue is taken into account, the loss is about $400 million. (ACIR estimated the loss to the losing States, including the State sales tax loss, at $391 million at 1975 levels. *Report*, table 19, pp. 64–65, note 4.)

[2] Since the end of fiscal year 1977, the only significant tax increases have been: Colorado from 10 to 15 cents, Florida from 17 to 21 cents, Indiana from 6 to 10.5 cents a pack. This should increase the problem of smuggling in these States but not change the overall pattern.

Source: Based on the estimate assuming no smuggling provided in *Cigarette Bootlegging: A State and Federal Responsibility,* A Commission Report, Advisory Commission on Intergovernmental Relations, A65, Table 19, pp. 64–65. The ratio between tax receipts assuming no evasion and actual receipts was applied to FY 77 actual collections. This is an update of Table 10, p. 30, of the *Report* which was 1975 levels. The two are essentially the same.

Municipal Cigarette Taxes

Seven States permit their municipalities to impose cigarette taxes. In only three States are there more than one or two such municipalities. However, in those States where only one or two such municipalities impose cigarette taxes, these municipalities are major cities. A list of States and the number of municipalities imposing cigarette taxes in those States is shown in table 2.

Table 2.—Data Relating to Municipal Cigarette Taxes in Selected States, FY 1975

State	Number of jurisdictions levying tax	Tax rate (cents)	Weighted average rate (cents)	Total revenue (thousands)	Number of packs taxed locally (thousands)	Per capita sales in taxing localities (packs)	Per capita sales in localities as percent of State average (percent)
Alabama[1]	237	1–5	NA	$8, 617	[2] NA	NA	NA
Missouri	101	1–10	4. 9	18, 711	383, 458	105. 7	77. 9
Illinois	[3] 2	5	5. 0	18, 332	366, 632	112. 2	85. 1
New Jersey	[4] 1	3	3. 0	247	8, 244	190. 0	155. 4
New York	[5] 1	[6] 4, 7 & 8	6. 0	45, 410	755, 483	99. 8	80. 5
Tennessee	[7] 2	1	1. 0	912	91, 246	125. 6	107. 0
Virginia	21	2–10	6. 5	13, 004	198, 723	97. 6	63. 9

NA–Not available.
[1] Some Alabama data is for fiscal year 1974.
[2] Jurisdictions taxing cigarettes represent 75.3 percent of State population.
[3] Chicago and Rosemont.
[4] Atlantic City.
[5] New York City.
[6] 8 cents effective Jan. 1, 1976.
[7] City of Memphis and Shelby County.

Source: ACIR staff compilation from data provided by the Tobacco Tax Council, Inc., Richmond, Va.; included in ACIR *Report*, p. 69.

Tax-Free Purchases of Cigarettes

The ACIR report also discussed the problem of tax-free sales on military bases and Indian reservations.[4]

Based on a comparison of Federal and State cigarette tax collections between fiscal years 1970 and 1975, the ACIR stated that an average of 1.74 billion packs of cigarettes (or 6.2 percent of total U.S. cigarette sales) were exempt from State and local taxation. Of this amount, nearly two-thirds was estimated to be due to the exemption of sales at military bases and the majority of the remainder to sales at Indian reservations.

Indian reservations.—ACIR indicated that five western States (Idaho, Montana, Nevada, New Mexico and Washington) consider the purcahse of tax-free cigarettes on reservations by non-Indians as a major evasion problem.

Military sales.—According to the ACIR, the purchase of tax-free cigarettes from military commissaries and exchanges for non-military persons generally is not done on an organized basis but can represent a significant revenue loss to the States. In a previous report, the ACIR commented as follows:

> The higher per capita sales figures for military store patrons . . . suggest either that military people consume more cigarettes on the average than do civilians (and this mainly in high-tax States), or that some military persons are buying tax-free cigarettes for the consumption of persons other than themselves and their dependents. In the absence of any reasons to assume that the military are heavier smokers than civilians or that high taxes promote heavy smoking, it is reasonable to conclude that cigarette bootlegging is a significant problem in some States.[5]

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[4] See *Report*, pp. 36 and 37.

[5] ACIR, *State Taxation of Military Income and Store Sales* (July 1976), p. 18, quoted in *Report*, p. 37.

III. Previous Government Actions and Recommendations for Action

Federal Action

Jenkins Act

The smuggling of cigarettes across State lines is not a Federal offense. The only Federal law applicable to cigarette smuggling is the Jenkins Act (15 USC 375–378), which was enacted in 1949.

The Jenkins act requires persons who ship cigarettes into other States to notify the tobacco tax administrators in these States of the names and addresses of the recipients and of the quantities, brands, and dates of mailing. The act also requires a business to provide tobacco administrators with its name, principal place of business, and the names of the officers of the business. Any person who violates these filing and reporting requirements faces punishment by a fine of not more than $1,000 and/or imprisonment for not more than 6 months. The act has limited usefulness for attacking the over-the-road smuggling problems that are of greatest concern to the States.[6]

As indicated by the ACIR, the Jenkins Act, together with the U.S. mail fraud law (18 USC 1341), has been successful in curtailing mail-order cigarette smuggling. A recent study of cigarette smuggling by the Federal Law Enforcement Assistance Administration (LEAA) found that only one State considered the mail-order purchase of cigarettes as its major problem, although a number of States listed mail-order sales as their second most serious smuggling problem.[7]

Federal Law Enforcement Assistance Administration

The Federal Government has assisted the States regarding the problem of cigarette smuggling with grants from the Law Enforcement Assistance Administration (LEAA). One grant under this program was used to establish the Interstate Revenue Research Center (IRRC), which is designed to reduce organized cigarette bootlegging. According to the ACIR, the center has achieved "modest success" in reducing cigarette smuggling.[8]

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[6] According to the ACIR, the Jenkins Act has proved effective only in discouraging the interstate mailing of cigarettes. This is because of an apparent deficiency in the language of the Jenkins Act, which has been interpreted as prohibiting only direct selling from a seller in a low-tax State to a buyer in a high-tax State. Under this interpretation, such transactions as those in which cigarettes are shipped into a low-tax State prior to their sale are not prohibited by the Act, nor are transactions in which an intermediary buys the cigarettes in a low-tax State and transports them into the high-tax State before he resells them. In addition, the relatively weak penalty for violation of the Jenkins Act has also inhibited enforcement. In addition to a weak fine and imprisonment provision, a civil suit may also be brought in a Federal court to enjoin future violations of the Act.

[7] Cited in ACIR *Report*, p. 27.

[8] *Report*, p. 29.

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Previous Federal-State tax equalization action

The Federal Government has previously entered the field of Federal-State tax equalization in two major instances: (1) estate (inheritance) taxes and (2) unemployment compensation taxes. First, in the area of the estate tax, the Ways and Means Committee in 1925 explained its reason for action:

> A very important change was also made in the application of the estate taxes. Under the present law a credit is allowed upon these taxes of the amount of any inheritance or estate tax paid to any State, up to 25 percent of the Federal tax. In order to give the various States full freedom to make use of this tax, the committee decided to extend the credit which might be so allowed up to 80 percent of the Federal tax. The several States, by the use of this provision, will be enabled to make use of the inheritance tax without additional cost to its citizens.[9]

Second, the Federal Unemployment Tax also provides that the taxpayer can receive credit against a Federal tax for State taxes paid. Section 3301 of the Internal Revenue Code imposes on employers a tax equal to 3.4 or 3.2 percent (depending on whether there is a balance of repayable advances made to the extended unemployed compensation account) of total annual wages earned by an employee. Under Section 3302, the employer may receive a maximum tax credit equal to 90 percent of the Federal tax for contributions he paid to a State unemployment insurance plan which has been federally approved. For purposes of the credit the Federal tax is computed at a deemed rate of 3 percent making the maximum total credit 2.7 percent. This means that there is a miminum Federal tax rate of .5 or .7 percent ((3.2—2.7) or (3.4—2.7)).

State Actions

States are making some attempt to reduce cigarette smuggling. The effort and success vary from State to State. Any overall assessment of effort is difficult, but it clearly has not stopped bootlegging. The ACIR report stated:

> [It] does not mean that tax administrators and law enforcement officials responsible for enforcing the cigarette tax laws are not making a substantial effort to stop bootlegging. However, given the limited resources they have to work with and the difficult nature of the problem, it is questionable whether they can be much more effective without greater support from all branches of State government and additional Federal assistance.[10]

One source of the greater enforcement problem of the States compared to the Federal Government is that the current Federal cigarette tax of 8 cents a pack is imposed on the manufacturer and there is no effect on Federal revenue regardless of what happens next. The States, however, impose their tax on the first wholesaler or distributor with which the State has contact. Thus, an individual may purchase cig-

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[9] U.S. Congress, House Committee on Ways and Means, *The Revenue Bill of 1926;* H. Rep. No. 1, 69th Cong. 1st Sess. (Dec. 7, 1925).

[10] *Report*, p. 32.

arettes in a low-tax State, pay the low tax, and then ship them to a high-tax State. An authorized distributor pays the tax only in the State in which he is located. Unless the high-tax State makes contact with him, the State cannot collect its tax.

Previous Governmental Recommendations

ACIR

In its May 1977 report, the ACIR recommended Federal contraband legislation and cooperative State enforcement efforts as well as other enforcement steps.[11] The ACIR discussed favorably but did not recommend an approach involving a Federal cigarette tax rebate to the States. The ACIR report and ACIR's testimony before the Senate Judiciary Committee, Subcommittee on Crime Laws and Procedures (October 21, 1977) and House Judiciary Subcommittee on crime (February 28, 1978) stated that the "contraband" approach would "at best" reduce only 30 percent of the annual cigarette tax revenue loss being suffered by the States due to smuggling.

Multistate Tax Commission

In May 1977 the Multistate Tax Commission urged Federal imposition of a uniform State and local cigarette tax.[12]

National Association of Tax Administrators (NATA) and National Tobacco Tax Association (NTTA)

In a statement to the ACIR in early 1977, the NATA and NTTA stressed the urgent need for prompt enactment of contraband legislation and that uniform Federal tax rate proposals should be studied.[13]

National Governors Association.—On February 28, 1978, before the Subcommittee on Crime of the House Judiciary Committee, Governor Milton Shapp of Pennsylvania testified on behal fof the National Governors' Association. He recommended both cigarette tax equalization and contraband legislation.

Treasury Department and the Justice Department.—The Treasury Department and the Justice Department support the "contraband" approach and are neutral on the "tax equalization" proposals, stating no official position on the latter (as incidated in testimony before the House Judiciary Subcommittee on Crime, March 8, 1978).

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[11] *Report*, pp. 5–7.

[12] Multistate Tax Commission news release (May 4, 1977). The Commission recommended a tax increase of 27 cents a pack, to be distributed to the States in proportion to population. The amount otherwise distributed would be reduced by any State or local cigarette tax collections.

[13] *Report*, pp. 95–99 and 102–105.

IV. Summary of Testimony Before the Subcommittee on Crime of the House Judiciary Committee on February 28 and March 28, 1978*

National Governors Association

Supported the enactment of both "tax equalization" and "contraband" legislation. Governor Milton Shapp, Chairman of the National Governors Association Committee on Fiscal Policy, noted that the only way to put an end to cigarette smuggling is to "eliminate the profit motive" (February 28 hearing).

U.S. Department of Justice

Supported the "contraband" approach and took no position on the "tax equalization" approach, noting that the Congress was the proper entity to pass judgment on tax equalization proposals. Edgar N. Best, of the FBI, noted that no Federal investigative agency could stop cigarette bootlegging (March 8 hearing); and John C. Keeney, Deputy Assistant Attorney General, Criminal Division noted that the tax approach was far more likely to cure the problem, and further commented that there would be no need for a contraband statute if Congress first passed a tax equalization measure (March 8 hearing).

Treasury Department

Supported the "contraband" approach and took no official position on the "tax equalization" approach. Indicated that the enforcement approach would not solve the problem, and that a uniform tax bill would be "more efficient." Noted certain "costs" of the "tax" approach but noted that tax uniformity would remove the motivation for smuggling (March 8 hearing).

International Association of Chiefs of Police

Supported the enactment of both "tax equalization" and "contraband" legislation, indicating that the "tax" approach would be an effective preventative measure and would "solve the problem once and for all;" whereas the "contraband" approach would result in only a 30 percent decrease in cigarette bootlegging (prepared statement submitted March 8, 1978).

Advisory Commission on Intergovernmental Relations

Supported the "contraband" approach and will clarify at its next Commission meeting on April 13 and 14, 1978, whether it will oppose the tax equalization approach, be neutral, or be supportive of it.

James H. Tully, Jr., Commissioner, New York State Department of Taxation and Finance

Supported both the "tax" approach and the "contraband" approach, commenting that the "contraband" approach was more likely to be enacted although the "tax" approach was a more effective solution.

Federation of Tax Administrators, National Tobacco Tax Association, and National Association of Tax Administrators

Favored the "contraband" approach and opposed the "tax" approach.

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*Source: Provided by the staff of the Subcommittee on Crime of the House Judiciary Committee.

V. Description of Bills To Be Considered During Public Hearing

Tax Equalization Only

H.R. 11152 (Messrs. Jones of Oklahoma, Bedell, Cotter, Duncan of Tennessee, Ms. Meyner, Pattison of New York, Pickle, Ms. Spellman and Conable) and

H.R. 10579 (Mr. Jones)

These bills would impose an additional Federal tax of 14 cents per pack of cigarettes. The receipts would go into a trust fund for payment to the States. Upon appropriation, payments would be made to States which *elect* to participate and reduce their State tax to no more than 3 cents a pack and eliminate all city cigarette taxes.

Most of the Federal revenue under these bills would be distributed to the States in two parts: (1) a "hold harmless" payment equal to the cigarette tax revenue the States "give up." This would be equal to the revenue the States would have taken in under State tax rates in effect on November 1, 1977, applied to actual sales (which would reflect the absence of smuggling) minus the revenues raised from the 3-cent tax States would still be permitted to levy if they chose to participate in the program; and (2) an "additional revenue" payment of one-half the remaining revenue from the 14-cent tax increase (or about $500 million) distributed in proportion to cigarette *sales*. An amount equal to this "additional revenue" payment (about $500 million) would go into the general fund of the Treasury. Any future increase in the Federal cigarette tax would be divided in the same way as the "additional revenue" payment, one-half to the States and one-half to the Federal Treasury.

The provisions of these bills would be effective one year after date of enactment.

H.R. 9667 (Mr. Pattison of New York)

The bill would increase the Federal cigarette tax by 27 cents a pack and pay to the States the excess of the Federal tax over the State tax. The bill would be effective two years after enactment.

Tax Equalization and Contraband Provisions

H.R. 10066 (Messrs. Drinan, Carr, Cotter, Edgar, McHugh, Murphy of Pennsylvania, Ottinger, Pattison of New York, Rosenthal, Scheuer, and Whalen. and

H.R. 9763 (Messrs. Drinan and Pattison of New York)

These bills would increase the Federal cigarette tax by 23 cents a pack and make payments to States which do not impose any cigarette tax. The distribution of payments would be in proportion to cigarette sales. The payment would be treated as a refund of tax (no appropriation).

In addition, the bills define contraband cigarettes as more than 20,000 cigarettes with no evidence of payment of applicable cigarette tax of the State in which they are found and which is not in the possession of an authorized person. An authorized person includes a common or contract carrier if the cigarettes are designated as such on the bill of lading. Under the bills, it is made illegal to transport or receive contraband cigarettes or make false statements concerning required records. Dealers must keep records and make them available for inspection and submit reports to the Secretary of the Treasury.

Also, penalties would be imposed of $10,000 and/or two years in jail, and contraband cigarettes and vehicles used in their transporting may be confiscated. The bills would not affect State laws.

These bills would be effective upon enactment.

H.R. 9722 (Mr. Drinan)

The bill would provide a Federal cigarette tax increase of 23 cents a pack and the same contraband provisions as H.R. 10066 and H.R. 9763. H.R. 9722 would establish a trust fund to which funds raised by the tax are authorized to be appropriated and from which funds may be appropriated to make payments to the States which reduce their cigarette taxes.

This bill would be effective generally on date of enactment.

H.R. 9733 (Mr. Biaggi) and H.R. 9905 (Mr. Rinaldo)

These bills would increase the Federal cigarette tax by 12 cents per pack. Also, they would establish a cigarette tax trust fund and appropriate 60 percent of the cigarette tax revenue to it.

The bills provide payment of that amount to States which do not have a State and local average cigarette tax in excess of 3 cents per pack. Payments, however, may not exceed 150 percent of the previous State-local cigarette tax receipts. This limitation would apply for 5 years. Any excess funds after this limitation are to be paid to States receiving a payment that is less than their previous cigarette tax receipts. Excess or insufficient funds are to be distributed in proportion to the original payment. Further, certain recordkeeping requirements are imposed by the bills.

These bills would be effective on the first day of the first calendar quarter beginning more than one year after enactment.

VI. Analysis of Tax Provisions of the Bills Before the Subcommittee

Effect of Tax Equalization on Tax-free Sales

Since the tax equalization bills either replace or nearly replace State and local cigarette taxes with a Federal tax, they automatically resolve the problem of tax-free sales from Indian reservations and military posts. The problem arises because cigarette sales from these places are not subject to State and local taxes. They are, however, subject to the Federal manufacturers excise tax.

H.R. 11152 and 10579

Cigarette tax revenue impact

At fiscal year 1977 levels, the current Federal cigarette tax of 8 cents a pack raised $2.358 billion. State cigarette taxes averaged 12 cents per pack and raised $3.483 billion for the States (see Table 3, col. 1), for a total of $5.841 billion. The combined Federal-State cigarette taxes amounted to an average of 20 cents per pack.

At these 1977 levels and at present tax rates, it is estimated that the States would have cigarette tax receipts of $3.914 billion in the absence of smuggling (table 3, col. 2).[14]

The 14-cents-per-pack Federal cigarette tax increase provided for under H.R. 11152 and H.R. 10579 would raise an estimated $4.047 billion at 1977 levels, for total Federal tax receipts of $6.405 billion, or a tax of 22 cents per pack at the Federal level. This would, in conjunction with the remaining 3-cents-per-pack State tax result in an overall Federal-State average cigarette tax rate of 25 cents per pack, a 5-cent-per-pack increase from the present 20-cents-per-pack average tax. Under these bills, State cigarette tax revenues would be reduced to about $863 million. The net Federal-State tax impact would be an overall tax increase of about $1.4 billion.

Of the $4.047 billion raised by the 14-cent Federal tax increase, $3.549 billion would be paid to the States (table 3, cols. 4 and 5). This is the sum of the "hold-harmless" payment of $3.051 billion (col. 4) and the $498 million "additional revenue" payment (col. 5). This amount, in addition to the $863 million the States would raise through a 3-cent per pack tax (col. 3), would increase the State's total cigarette tax receipts to an estimated $4.412 billion (col. 6). This is 127 percent of what the States raised in fiscal year 1977 (col. 7) and 113 percent of what the States could expect to raise at current tax rates without cigarette smuggling (col. 8).

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[14] The $3.805 billion estimated State receipts shown in table 1, col. 2, reflects FY 1977 rates. The difference between these two amounts reflects rate increases between 6/30/77 and 11/1/77.

Table 3.—Estimated Revenue Impact of H.R. 11152 and H.R. 10579: Distribution of Part of a 14-cent Federal Cigarette Tax to "Hold Harmless" Those States that Reduce Their Tax to 3 cents, and One-Half of the Rest to Eligible States in Proportion to Cigarette Sales, Fiscal Year 1977 Levels

(Dollar amounts in millions)

States	State cigarette tax receipts			Federal payment (est.)		Total State receipts [(3)+(4)+(5)]	Total receipts as % of actual [(6)÷(1)]	Total receipts as % of est.—col. (2) [(6)÷(2)]
	Actual (FY 77)	Without smuggling (est.)	From 3 cents tax	"Hold harmless" [(2)−(3)]	"Additional revenue"			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
U.S. total	$3, 483	$3, 914	$863	$3, 051	$498	$4, 412	127%	113%
Alabama	47. 6	52. 7	13. 2	39. 5	8. 0	60. 7	128	115
Alaska	4. 8	4. 6	1. 7	2. 9	. 8	5. 4	112	117
Arizona	35. 0	38. 3	8. 8	29. 5	4. 5	42. 8	122	112
Arkansas	44. 1	51. 1	8. 7	42. 4	4. 7	55. 8	126	109
California	269. 7	281. 6	84. 5	197. 1	48. 3	329. 9	122	117
Colorado	32. 7	*48. 6	9. 7	38. 9	5. 5	54. 1	165	111
Connecticut	76. 0	91. 2	13. 0	78. 2	7. 8	99. 0	130	108
Delaware	12. 2	12. 4	2. 7	9. 7	1. 4	13. 8	113	111
District of Columbia	12. 4	12. 2	2. 8	9. 4	2. 0	14. 2	114	116
Florida	187. 0	*271. 4	38. 7	232. 7	21. 4	292. 8	156	108
Georgia	73. 6	76. 1	19. 0	57. 1	11. 0	87. 1	118	114
Hawaii	9. 3	*10. 1	2. 5	7. 6	1. 3	11. 4	122	113
Idaho	9. 0	8. 7	2. 9	5. 8	1. 6	10. 3	114	118
Illinois	178. 5	196. 0	49. 0	147. 0	27. 4	223. 4	125	114
Indiana	52. 8	*86. 1	24. 6	61. 5	12. 2	98. 3	186	114
Iowa	45. 5	48. 7	11. 2	37. 5	6. 8	55. 5	122	114
Kansas	31. 4	32. 8	8. 4	23. 9	5. 1	37. 9	121	116
Kentucky	22. 3	14. 5	14. 5	------------	7. 6	22. 1	(99)	152
Louisiana	55. 6	57. 5	15. 5	42. 0	8. 1	65. 6	118	114
Maine	24. 3	26. 8	5. 0	21. 8	2. 4	29. 2	120	109

Maryland	54. 4	54. 2	16. 3	37. 9	9. 9	64. 1	118	118
Massachusetts	143. 2	157. 4	22. 4	135. 0	14. 4	171. 8	120	109
Michigan	139. 1	145. 1	39. 2	105. 9	21. 4	166. 5	120	115
Minnesota	82. 0	94. 2	15. 6	78. 6	9. 2	103. 4	126	110
Mississippi	29. 0	30. 0	8. 1	21. 9	4. 8	34. 8	120	116
Missouri	59. 4	63. 0	20. 8	42. 2	11. 3	74. 3	125	118
Montana	11. 1	11. 4	2. 9	8. 5	1. 5	12. 9	116	113
Nebraska	22. 6	24. 0	5. 5	18. 5	3. 4	27. 4	121	114
Nevada	11. 0	10. 7	3. 2	7. 5	1. 9	12. 6	114	118
New Hampshire	26. 8	14. 3	3. 6	10. 7	1. 9	16. 2	(60)	113
New Jersey	168. 8	194. 6	30. 6	164. 0	18. 2	212. 8	126	109
New Mexico	13. 9	14. 7	3. 7	11. 0	2. 1	16. 8	121	114
New York	336. 1	394. 6	78. 9	315. 7	45. 8	440. 4	131	112
North Carolina	20. 3	13. 4	13. 4	----------	12. 4	25. 8	127	192
North Dakota	8. 4	8. 6	2. 3	6. 3	1. 3	9. 9	118	115
Ohio	197. 8	214. 4	42. 9	171. 5	25. 3	239. 7	121	112
Oklahoma	48. 5	49. 8	11. 5	38. 3	5. 7	55. 5	114	111
Oregon	32. 0	30. 4	10. 0	20. 4	5. 0	35. 4	111	116
Pennsylvania	247. 9	281. 5	46. 7	234. 8	29. 1	310. 6	125	110
Rhode Island	24. 4	24. 8	4. 1	20. 7	2. 3	27. 1	111	109
South Carolina	22. 3	*24. 8	10. 7	14. 1	6. 1	30. 9	138	124
South Dakota	9. 0	9. 1	2. 3	6. 0	1. 4	10. 5	117	115
Tennessee	66. 7	73. 4	16. 9	56. 5	9. 6	83. 0	124	113
Texas	276. 1	323. 9	52. 5	271. 4	27. 8	351. 7	127	108
Utah	7. 4	7. 2	2. 7	4. 5	1. 4	8. 6	116	119
Vermont	9. 4	8. 4	2. 1	6. 3	1. 1	9. 5	101	113
Virginia	17. 8	16. 9	16. 9	----------	11. 9	28. 8	162	170
Washington	56. 8	67. 5	12. 6	54. 9	7. 8	75. 3	132	112
West Virginia	28. 1	29. 7	7. 4	22. 3	4. 2	33. 9	121	114
Wisconsin	84. 6	96. 6	18. 1	78. 5	10. 7	107. 3	127	111
Wyoming	4. 7	4. 5	1. 7	2. 8	. 8	5. 3	113	118

The detailed explanation of the derivation of each column is as follows:

Col. (1)—Actual net State cigarette tax receipts for fiscal year 1977. From *The Tax Burden on Tobacco*, Historical Compilation, Volume 12, 1977, Tobacco Tax Council, Inc., Table 9, page 18.

Col. (2)—Based on the estimate assuming no smuggling provided in *Cigarette Bootlegging: A State and Federal Responsibility*, A Commission Report, Advisory Commission on Intergovernmental Relations, A65, Table 19, pp. 64–65. The ratio between tax receipts assuming no evasion and actual receipts was applied to FY '77 actual collections and further adjusted proportionately for those tax increases which occurred between June 30, 1977, and Nov. 1, 1977, for the States indicated by (*).

Col. (3)—Based on sales without smuggling used for (2).

Col. (4)—"Hold harmless" Federal payment to eligible States. Assumes all States elect. Equals the excess of estimated receipts in (2) over revenue from a 3-cent per pack tax except for Kentucky, North Carolina and Virginia, which remain at 3 cents, 2 cents and 2.5 cents, respectively.

Col. (5)—The "additional revenue" Federal payment made to eligible States is one-half of the difference between total Federal receipts from the 14-cent tax increase and the "hold harmless" payment to States. An equal amount goes to the general fund of the Treasury. The distribution of the "additional reveune" is made in proportion to actual cigarette sales (not cigarette tax receipts). For purposes of this estimate, estimated sales in the absence of smuggling are used. Total Federal receipts at FY 1977 levels from the additional 14-cent tax are estimated at $4.047 billion; $1/2(4.047-3.051) = 1/2(996) = 498$. This estimate takes into account the estimated decrease in cigarette sales from the 14-cent Federal tax increase offset by the approximately 9-cents per pack State tax decrease. The FY 1977 cigarette sales were 29.81 billion packs (*The Tax Burden on Tobacco*, Table 3, p. 16). The estimated reduction in sales is 909 million packs or 3 percent. This is based on a price elasticity of demand of −.34 used in the ACIR report cited above, p. 84. The FY 1979 Federal Budget estimates Federal cigarette tax receipts increasing at about 2.4 percent a year up to FY 1979, (*Budget of the United States Government*, p. 437). At that rate of growth the FY 1979 additional payment $498 million would be about $522 million.

Col. (6)—Total State receipts under this bill equal to the sum of the receipts raised from the States' 3-cent per pack cigarette tax and the two Federal payments. Assumes all States participate.

Col. (7)—Comparison of total State receipts under this bill and actual FY 1977 State cigarette tax collections, (6) ÷ (1).

Col. (8)—Comparison of total State receipts under this bill and estimated State cigarette tax receipts at present tax rates and no smuggling. Emphasizes that the States would be better off in terms of receipts under these bills than if smuggling were eliminated some other way.

For example, as shown on table 3, Alabama currently raises $47.6 million from cigarette taxes (col. 1), and would raise $52.7 million in the absence of smuggling (col. 2). Alabama would raise $13.2 million from a 3-cents-a-pack tax (col. 3). The "hold harmless" payment under the bill is therefore $52.7 million minus $13.2 million, or $39.5 million (col. 4). The "additional revenue" payment is $8.0 million (col. 5), and the total State receipts are the total of the 3-cents-a-pack tax revenue of $13.2 million and the two Federal payments, $39.5 million and $8.0 million, for a total of $60.7 million (col. 6). This amount is 128 percent (a 28-percent increase) of FY 1977 actual receipts (col. 7) and 115 percent of what the State would have received in the absence of smuggling (col. 8).

The expected decrease in cigarette sales from the 14-cents per pack Federal tax increase and the approximately 9 cents per pack average State tax decrease is estimated to be 909 million packs or 3 percent. (This derivation of this estimate is explained in note for column 5 of table 3.) As indicated in the same note, the expected annual growth in Federal cigarette tax receipts (and hence cigarette sales) is 2.4 percent a year. Thus, the 14 cents a pack tax increase would offset about one year's growth in cigarette sales.

The impact of the bills on the consumer price index (CPI) is indicated by comparing the net tax increase of $1.4 billion to about $1.2 trillion of consumer expenditures, or a one-time increase of about one-tenth of one percent in the CPI.

At the projected rate of growth of 2.4 percent a year, the receipts from the 14-cent additional Federal cigarette tax would increase from $4.047 billion in fiscal year 1977 to $4.345 billion in fiscal year 1980. At this rate of increase, the "hold harmless" payment to the States would be expected to increase from $3.051 billion in fiscal year 1977 to $3.276 billion in 1980, and the "additional revenue" payment to States would increase from $498 million to $534 million.

Table 3 emphasizes that for all except two States, State cigarette tax receipts would be higher under the bills than they actually were in fiscal year 1977 (col. 7). The two States are Kentucky (which almost breaks even) and New Hampshire. It also shows that receipts would be higher than they would be in the absence of smuggling in all States (col. 8).

Distributional impact on States

A different way of evaluating the revenue impact of H.R. 10579 and H.R. 11152 is shown in table 4. This table, prepared by the Federation of Tax Administrators, emphasizes the redistributive impact of the bills. It shows, on a cents per pack basis, that in most States cigarette consumers would pay more in increased Federal cigarette taxes than their State government would receive from the Federal payment. In 38 States the tax increase would be greater than the increased Federal payment and in 12 States the Federal payment would be greater than the tax increase.

For example, in Alabama (as in all States) the Federal tax increase would be 14 cents. Alabama would receive from the Federal Government 9 cents per pack under Step 1 (the "hold-harmless" distribution) and 1.5 cents a pack under step 2 (the "additional revenue" distribution). The total payment is the sum of these two payments, 9 cents plus 1.5 cents, for a total of 10.5 cents. This is 3.5 cents a pack less than the 14-cent-per-pack tax increase and makes Alabama a "losing State" in this sense. (The present tax and the 3-cent tax remaining is not used in this evaluation.)

Table 4.—State-by-State Losses and Gains as a Result of Imposition and Distribution of Added 14-cent Federal Tax Under H.R. 11152 and H.R. 10579 as Measured by Tax Rate Per Pack

State	Present tax	Distribution under the bills[1]			Losing States[2]	Gaining States[3]
		Step 1	Step 2	Total		
Alabama	12	9	1.5	10.5	3.5	--------
Alaska	8	5	1.5	6.5	7.5	--------
Arizona	13	10	1.5	11.5	2.5	--------
Arkansas	17.75	14.75	1.5	16.25	--------	2.25
California	10	7	1.5	8.5	5.5	--------
Colorado	15	12	1.5	13.5	.5	--------
Connecticut	21	18	1.5	19.5	--------	5.5
Delaware	14	11	1.5	12.5	1.5	--------
District of Columbia	13	10	1.5	11.5	2.5	--------
Florida	21	18	1.5	19.5	--------	5.5
Georgia	12	9	1.5	10.5	3.5	--------
Hawaii	12	9	1.5	10.5	3.5	--------
Idaho	9.1	6.1	1.5	7.6	6.4	--------
Illinois	12	9	1.5	10.5	3.5	--------
Indiana	10.5	7.5	1.5	9	5.0	--------
Iowa	13	10	1.5	11.5	2.5	--------
Kansas	11	8	1.5	9.5	4.5	--------
Kentucky	3	--------	1.5	1.5	12.5	--------
Louisiana	11	8	1.5	9.5	4.5	--------
Maine	16	13	1.5	14.5	--------	.5
Maryland	10	7	1.5	8.5	5.5	--------
Massachusetts	21	18	1.5	19.5	--------	5.5
Michigan	11	8	1.5	9.5	5.5	--------
Minnesota	18	15	1.5	16.5	--------	2.5
Mississippi	11	8	1.5	9.5	4.5	--------
Missouri	9	6	1.5	7.5	6.5	--------
Montana	12	9	1.5	10.5	3.5	--------
Nebraska	13	10	1.5	11.5	2.5	--------
Nevada	10	7	1.5	8.5	5.5	--------
New Hampshire	12	9	1.5	10.5	3.5	--------
New Jersey	19	16	1.5	17.5	--------	3.5
New Mexico	12	9	1.5	10.5	3.5	--------
New York	15	12	1.5	13.5	.5	--------
North Carolina	2	--------	1.5	1.5	12.5	--------
North Dakota	11	8	1.5	9.5	4.5	--------
Ohio	15	12	1.5	13.5	.5	--------
Oklahoma	13	10	1.5	11.5	2.5	--------
Oregon	9	6	1.5	7.5	6.5	--------
Pennsylvania	18	15	1.5	16.5	--------	2.5
Rhode Island	18	15	1.5	16.5	--------	2.5
South Carolina	7	4	1.5	5.5	8.5	--------
South Dakota	12	9	1.5	10.5	3.5	--------
Tennessee	13	10	1.5	11.5	2.5	--------
Texas	18.5	15.5	1.5	17.0	--------	3.0
Utah	8	5	1.5	6.5	7.5	--------
Vermont	12	9	1.5	10.5	3.5	--------
Virginia	2.5	--------	1.5	1.5	12.5	--------
Washington	16	13	1.5	14.5	--------	.5
West Virginia	12	9	1.5	10.5	3.5	--------
Wisconsin	16	13	1.5	14.5	--------	.5
Wyoming	8	5	1.5	6.5	7.5	--------

[1] The amount of payment per pack under step 1 and step 2 are simply the amounts from Table 3, columns 4 and 5, divided by the number of packs of cigarettes sold in the particular State and rounded.

[2] States in which cigarette taxpayers will pay more in additional Federal cigarette taxes (14¢) than their State government will receive under these bills.

[3] States in which cigarette taxpayers will pay less additional Federal cigarette taxes (14¢) than their State government will receive under these bills.

Source: Federation of Tax Administrators.

A somewhat different way of showing the same pattern is provided by table 5. This table shows the present State per pack cigarette tax rates (col. 1), the excess of the 14-cent Federal tax plus the 3-cent State tax over the present tax (col. 2), and the dollar amount of Federal receipts from the 14-cent tax, $4.047 billion (col. 4). The total Federal payment of $3.549 billion is shown in column 6. The excess of Federal receipts over payments, $498 million, is the amount that would be retained by the Federal Treasury (col. 7). The magnitude of this excess is shown by State (a negative excess means the State gains in the same sense as shown by table 4).

For example, in Alabama, the current cigarette tax is 12 cents a pack (col. 1) and the excess of a 17-cents-a-pack tax (14 cents Federal plus 3 cents remaining State tax) is 5 cents (col. 2). The State receipts from current rates is $47.6 million (col. 3). Federal receipts from the 14-cent tax is $64.3 million. This is a tax increase of $16.7 million—$64.3 million minus $47.6 million (col. 5). The total Federal payment is $47.5 million (col. 6). The excess of Federal receipts from the 14-cent tax in Alabama over the payment is $16.8 million (col. 7), which is the excess of column (4) over column (6).

Table 5.—Estimated Federal and State Tax Changes and Federal Payments Under H.R. 10579 and H.R. 11152 (Fiscal Year 1977)

(Dollar amounts in millions)

States	State cigarette tax rate as of Nov/1/77 (cents) (1)	Excess of 17-cent tax over State tax [1] (cents) (2)	State receipts from Nov/1/77 rates [2] (3)	Federal receipts from 14-cent tax [3] (4)	Tax increase [(4)−(3)] (5)	Total Federal payment [4] (6)	Excess receipts over payments [5] [(4)−(6)] (7)	State tax reduction [6] (8)
U.S. total	**[7] NA**	**[7] NA**	**$3,588**	**$4,047**	**$459**	**$3,549**	**$498**	**$2,620**
Alabama	12	5.0	47.6	64.3	16.7	47.5	16.8	34.4
Alaska	9	7.0	4.8	6.5	1.7	3.7	2.8	3.1
Arizona	13	4.0	35.0	36.8	1.8	34.0	2.8	26.2
Arkansas	17.75		44.1	38.0	−6.1	47.1	−9.1	35.4
California	10	7.0	269.7	392.6	122.9	245.4	147.2	185.2
Colorado	15	2.0	*49.0	44.9	−4.1	44.4	.5	23.0
Connecticut	21		76.0	63.5	−12.5	86.0	−22.5	63.0
Delaware	14	3.0	12.2	11.3	−.9	11.1	.2	9.5
District of Columbia	13	4.0	12.4	16.2	3.8	11.4	4.8	9.6
Florida	21		*230.9	174.0	−56.9	254.1	−80.1	148.3
Georgia	12	5.0	73.6	89.4	15.8	68.1	21.3	54.6
Hawaii	12	5.0	*10.1	10.5	.4	8.9	1.6	6.8
Idaho	9.1	7.9	9.0	13.0	4.0	7.4	5.6	6.1
Illinois	12	5.0	178.5	223.0	44.5	174.4	48.6	129.5
Indiana	10.5	6.5	*92.4	99.2	6.8	73.7	25.5	28.2
Iowa	13	4.0	45.5	55.4	9.9	44.3	11.1	34.3
Kansas	11	6.0	31.4	41.3	9.9	29.0	12.3	23.0
Kentucky	3	14.0	22.3	61.5	39.2	7.6	53.9	7.8
Louisiana	11	6.0	55.6	65.6	10.0	50.1	15.5	40.1
Maine	16	1.0	24.3	19.4	−4.9	24.2	−4.8	19.3

Maryland	10	7.0	54.4	80.5	26.1	47.8	32.7	38.1
Massachusetts	21	------------	143.2	117.0	−26.2	149.4	−32.4	120.8
Michigan	11	6.0	139.1	174.0	34.9	127.3	46.7	99.9
Minnesota	18	------------	82.0	74.9	−7.1	87.8	−12.9	66.4
Mississippi	11	6.0	29.0	38.9	11.9	26.7	12.2	20.9
Missouri	9	8.0	59.4	91.9	32.5	53.5	38.4	38.6
Montana	12	5.0	11.1	12.5	1.4	10.0	2.5	8.2
Nebraska	13	4.0	22.6	27.5	4.9	21.9	5.6	17.1
Nevada	10	7.0	11.0	15.8	4.8	9.4	6.4	7.8
New Hampshire	12	5.0	26.8	15.4	−11.4	12.6	2.8	23.2
New Jersey	19	------------	168.8	148.1	−20.7	182.2	−34.1	138.2
New Mexico	12	5.0	13.9	17.4	3.5	13.1	4.3	10.2
New York	15	2.0	336.1	372.3	36.2	361.5	10.8	257.2
North Carolina	2	[1] 14.0	20.3	100.4	80.1	12.4	88.0	6.9
North Dakota	11	6.0	8.4	10.9	2.5	7.6	3.3	6.1
Ohio	15	2.0	197.8	206.0	8.2	196.8	9.2	154.9
Oklahoma	13	4.0	48.5	46.5	−2.0	44.0	2.5	37.0
Oregon	9	8.0	32.0	40.9	8.0	25.4	15.5	22.0
Pennsylvania	18	------------	247.9	236.3	−11.6	263.9	−27.6	201.2
Rhode Island	18	------------	24.4	18.6	−5.8	23.0	−4.4	20.3
South Carolina	7	10.0	*26.0	49.4	23.4	20.2	29.2	11.6
South Dakota	12	5.0	9.0	11.3	2.3	7.4	3.9	6.7
Tennessee	13	4.0	66.7	78.1	11.4	66.1	12.0	49.8
Texas	18.5	------------	276.1	226.2	−49.9	299.2	−73.0	223.6
Utah	8	9.0	7.4	11.7	4.3	5.9	5.8	4.7
Vermont	12	5.0	9.4	8.9	−.5	7.4	1.5	7.3
Virginia	2.5	[1] 14.0	17.8	96.3	78.5	11.9	84.4	.9
Washington	16	1.0	56.8	59.0	2.2	62.7	−3.7	44.2
West Virginia	12	5.0	28.1	34.0	5.9	26.5	7.5	20.7
Wisconsin	16	1.0	84.6	87.0	2.4	89.2	−2.2	66.5
Wyoming	8	9.0	4.7	6.5	1.8	3.6	2.9	3.0

[1] Tax of 14 cents Federal and 3 cents State except for North Carolina (2 cents) and Virginia (2.5 cents) (State rates as of Nov. 1, 1977).

[2] Differs from actual receipts for FY 1977 only for those States with (*) to reflect change in rates. FY 77 sales reflect smuggling.

[3] Receipts from 14-cent Federal tax (estimated without smuggling).

[4] "Hold harmless" plus "additional revenue" (FY 1977 levels).

[5] Excess of Federal receipts over Federal payments (FY 1977 levels).

[6] Fiscal year 1977 receipts minus revenue from "3-cent tax," no smuggling.

[7] Average tax of 12.15 cents and 4.85 cents respectively for FY 1977.

It should be noted that any equalizing tax approach which rebates money to the States must be redistributive in some fashion. H.R. 10579 and H.R. 11152 redistribute money from the low-tax States, some to the Federal Government, and some to the high-tax States under the "hold harmless" payment. The "additional payment" favors the low-tax States since it is distributed on the basis of sales. An alternative approach would be to distribute funds on the basis of cigarette sales. This is the method used in most of the contraband plus tax equalization bills discussed below and analyzed in table 7. A distribution of this type strongly favors low-tax States relative to high-tax States since the Federal tax replaces the State tax, resulting in increases of State cigarette tax receipts of *several hundred percent* over present levels. This distribution pattern is redistributive not from the citizens of one State to another, but relative to the taxes currently paid and the State government receipts in the high-tax States compared to the low-tax States.

Thus, the fact that an equalizing tax and rebate proposal is redistributive and affects high- and low-tax States differently is inevitable and not in itself a sufficient criticism of the proposal. Further questions such as the overall impact of the proposal, the degree of redistribution compared to other plans, and how it compares to the alternatives are still relevant.

Effect on revenue sharing

The reduction of State cigarette taxes will, of course, reduce overall State tax receipts (see table 5, col. 8). Table 6 shows the effect on General Revenue Sharing payments by State as the result of relative reductions in the State-local tax effort factor used in the revenue sharing formula. The total Federal revenue sharing amount would not change, only the distribution among the States.

The results indicate two things: (1) the changes would be small, seldom over 2 percent of the payments (col. 4); and (2) the distribution would be shifted in favor of the low-tax States and would reduce the "tilt" of the "hold harmless" payment under H.R. 11152 and H.R. 10579 toward the high tax States. This is shown by adjusting the original excess receipts over payments amount (col. 2) for the change in the Federal payment under revenue sharing (col. 3). This yields a new excess of receipts over payment amount (col. 5) and hence a new excess of receipts over payment amount (col. 6). From this, a change in excess receipts over payments can be calculated (col. 7). This shows that for most of those States that had an excess receipts over payments amount, the excess would be reduced; and for those who had an excess of payments over receipts (negative excess receipts over payments), the excess payments would be reduced. In other words, the effect on revenue sharing would be redistributive in favor of the low-tax States relative to the distribution pattern of H.R. 11152 and H.R. 10579.

Table 6.—Effect of H.R. 11152 and H.R. 10579 on State Distribution Under General Revenue Sharing and Comparison to Federal Payments and Receipts Under These Bills

(Dollar amounts in millions)

State	Total Federal payments under these bills [1]	Excess receipts over payments [2]	Change in revenue sharing distribution: Amount [3]	Change in revenue sharing distribution: Percentage	Change in revenue sharing payment plus: Federal payment [(1)+(3)]	Change in revenue sharing payment plus: Excess receipts over payments [(2)—(3)]	Change in excess receipts over payments [(6)—(2)]
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
U.S. total	$3, 549	$498					
Alabama	47. 5	16. 8	−0. 32	−0. 30	47. 18	17. 12	0. 32
Alaska	3. 7	2. 8	. 03	. 22	3. 73	2. 77	−. 03
Arizona	34. 0	2. 8	. 25	. 39	34. 25	2. 55	−. 25
Arkansas	47. 1	−9. 1	−1. 46	−2. 10	45. 64	−7. 64	1. 46
California	245. 4	147. 2	2. 45	. 35	247. 85	144. 75	−2. 45
Colorado	44. 4	. 5	. 13	. 18	44. 53	. 37	−. 13
Connecticut	86. 0	−22. 5	−. 24	−. 28	85. 76	−22. 26	. 24
Delaware	11. 1	. 2	−. 02	−. 10	11. 08	. 22	. 02
District of Columbia	11. 4	4. 8	. 10	. 34	11. 50	4. 7	. 10
Florida	254. 1	−80. 1	−2. 71	−1. 32	251. 39	−77. 39	2. 71
Georgia	68. 1	21. 3	−. 34	−. 24	67. 76	21. 64	. 34
Hawaii	8. 9	1. 6	. 12	. 38	9. 02	1. 48	−. 12
Idaho	7. 4	5. 6	. 19	. 76	7. 59	5. 41	−. 19
Illinois	174. 4	48. 6	. 50	. 15	174. 90	48. 10	−. 50
Indiana	73. 7	25. 5	1. 42	1. 01	75. 12	24. 08	−1. 42
Iowa	44. 3	11. 1	. 06	. 08	44. 36	11. 04	−. 06
Kansas	29. 0	12. 3	. 22	. 37	29. 22	12. 08	−. 22
Kentucky	7. 6	53. 9	1. 67	1. 52	9. 27	52. 23	−1. 67

Louisiana	50.1	15.5	−.12	−.08	49.98	15.62	.12
Maine	24.2	−4.8	−.33	−.82	23.87	−4.47	.33
Maryland	47.8	32.7	.64	.48	48.44	32.06	−.64
Massachusetts	149.4	−32.4	−.02	−.01	149.38	−32.38	.02
Michigan	127.3	46.7	.39	.14	127.69	46.31	−.39
Minnesota	87.8	−12.9	−.13	−.10	87.67	−12.77	.13
Mississippi	26.7	12.2	.33	.33	27.03	11.87	−.33
Missouri	53.5	38.4	.46	.37	53.96	37.94	−.46
Montana	10.0	2.5	.04	.14	10.04	2.46	−.04
Nebraska	21.9	5.6	.07	.16	21.97	5.53	−.07
Nevada	9.4	6.4	−.03	−.22	9.37	6.43	.03
New Hampshire	12.6	2.8	−.69	−3.26	11.91	3.49	.69
New Jersey	182.2	−34.1	−.56	−.27	181.64	33.54	.56
New Mexico	13.1	4.3	.13	.30	13.23	4.17	−.13
New York	361.5	10.8	1.84	.25	363.34	8.96	−1.84
North Carolina	12.4	88.0	3.35	2.04	15.75	84.65	−3.35
North Dakota	7.6	3.3	.05	.33	7.65	3.25	−.05
Ohio	196.8	9.2	−.41	−.16	196.39	9.61	.41
Oklahoma	44.0	2.5	−.92	−1.25	43.08	3.42	.92
Oregon	25.4	15.5	.09	.13	25.31	15.59	−.09
Pennsylvania	263.9	−27.6	−2.18	−.63	261.72	−25.42	2.18
Rhode Island	23.0	−4.4	−.04	−.16	22.96	−4.36	.04
South Carolina	20.2	29.2	.97	1.04	21.17	28.23	−.97
South Dakota	7.4	3.9	.04	.21	7.44	3.86	−.04
Tennessee	66.1	12.0	−.76	−.62	65.34	12.76	.76
Texas	299.2	−73.0	−5.40	−1.62	293.80	−67.60	5.40
Utah	5.9	5.8	.44	1.18	6.34	5.36	−.44
Vermont	7.4	1.5	−.03	−.17	7.37	1.53	.03
Virginia	11.9	84.4	.77	.58	12.67	83.63	−.77
Washington	62.7	.8	−.01	−.01	62.69	.81	.01
West Virginia	26.5	7.5	−.12	.20	26.38	7.62	.12
Wisconsin	89.2	−2.2	.03	.02	89.23	−2.23	−.03
Wyoming	3.6	2.9	.09	.82	3.69	2.81	−.09

[1] Col. 6, table 5.
[2] Col. 7, table 5.
[3] The total amount distributed was $6.622 billion in entitlement period 8, July 1977. Data and calculations from the Office of Revenue Sharing, U.S. Treasury Department.

H.R. 10066, H.R. 9763 and H.R. 9722 [15]

These bills would impose a Federal cigarette tax of 23 cents a pack, which would be distributed in proportion to cigarette sales (Table 7). At fiscal year 1977 levels, the Federal tax increase would be $6.391 billion. This would be offset by a decrease of State cigarette taxes of $3.483 billion, for a net increase of $2.908 billion. At fiscal year 1980 levels the gross and net tax increases are estimated to increase to $6.86 billion and $3.12 billion, respectively.[16]

The decrease in cigarette sales under these bills is estimated (at 1977 levels) to be about 2 billion packs, or 6.8 percent of sales (slightly less than 3 years growth in sales).[17] The impact of the bills on the consumer price index is indicated by comparing the net tax increase of $2.9 billion to about $1.2 trillion of consumer expenditures, or a one-time increase of about two-tenths of one percent in the CPI.

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[15] The same principal but different numbers apply to H.R. 9667 (a Federal cigarette tax of 27 cents), which distributes to the State the excess of the Federal tax collection over the State tax collection. A different analysis, not shown here, applies to H.R. 9733 and H.R. 9905, which would impose a tax of 12 cents per pack and limit the Federal distribution to 150 percent of the previous State collections for a period of 5 years.

[16] Assuming the 2.4 percent per year growth from note 5 to table 3.

[17] Using the same method described in note 5 to table 3.

The effect of the tax and distribution provisions of these bills is shown by State in table 7, which assumes that all States would be eligible because they would not be imposing any cigarette tax under this program. The table shows the actual State cigarette tax collections in fiscal year 1977 (col. 1); the revenue raised from each State and distributed to it under the bills (col. 2); the increase in taxes paid and funds received by each State (col. 3); and this increase expressed as a percent in FY 1977 actual receipts (col. 4).

The principal point of table 7 is that the distribution formula, while not distributing funds raised in one State to another, substantially increases the tax in and the receipts of the low-tax States. For example, as shown in column 4, the States of Kentucky, North Carolina, and Virginia would receive increases in receipts which represent 335, 681, and 754 percent of their 1977 cigarette tax receipts, respectively.

Table 7.—H.R. 10066, 9763 and 9722: Comparison of State Cigarette Tax Collections (FY 1977) and Distribution of 23-cent Federal Tax in Proportion To Sales [1]

[Dollar amounts in millions]

State	State cigarette tax collections, FY 1977 (1)	23-cent Federal cigarette tax revenue distributed in proportion to sales [1] (2)	Increase in taxes paid and State receipts [(2)−(1)] (3)	Increase as a percent of FY 1977 receipts [(3)÷(1)] (4)	Percentage distribution of col. (2) (5)
U.S. Total	**$3, 483**	**$6, 391**	**$2, 908**	**83%**	**100. 0%**
Alabama	47. 6	101. 6	54. 0	113	1. 59
Alaska	4. 8	10. 2	5. 4	112	. 16
Arizona	35. 0	58. 2	23. 2	66	. 91
Arkansas	44. 1	60. 1	16. 0	36	. 94
California	269. 7	619. 9	350. 2	130	9. 70
Colorado	32. 7	70. 9	38. 2	117	1. 11
Connecticut	76. 0	100. 3	24. 3	33	1. 57
Delaware	12. 2	17. 9	5. 7	47	. 28
District of Columbia	12. 4	25. 6	13. 2	106	. 40
Florida	187. 0	274. 8	87. 8	47	4. 30
Georgia	73. 6	141. 2	67. 6	92	2. 21
Hawaii	9. 3	16. 6	7. 3	78	. 26
Idaho	9. 0	20. 5	11. 5	128	. 32
Illinois	178. 5	352. 1	173. 6	97	5. 51
Indiana	52. 8	156. 6	103. 8	197	2. 45
Iowa	45. 5	87. 6	42. 1	93	1. 37
Kansas	31. 4	65. 2	33. 8	108	1. 02
Kentucky	22. 3	97. 1	74. 8	*335	1. 52

Louisiana	55.6	103.5	47.9	86	1.62
Maine	24.3	30.7	6.4	26	.48
Maryland	54.4	127.2	72.8	134	1.99
Massachusetts	143.2	184.7	41.5	29	2.89
Michigan	139.1	274.8	135.7	98	4.30
Minnesota	82.0	118.2	36.2	44	1.85
Mississippi	29.0	61.4	32.4	112	.96
Missouri	59.4	145.1	85.7	144	2.27
Montana	11.1	19.8	8.7	78	.31
Nebraska	22.6	43.5	20.9	92	.68
Nevada	11.0	24.9	13.9	126	.39
New Hampshire	26.8	24.3	(−2.5)	(−9)	.38
New Jersey	168.8	233.9	65.1	39	3.66
New Mexico	13.9	27.5	13.6	98	.43
New York	336.1	588.0	251.9	75	9.20
North Carolina	20.3	158.5	138.2	*681	2.48
North Dakota	8.4	17.3	8.9	106	.27
Ohio	197.8	325.3	127.5	64	5.09
Oklahoma	48.5	73.5	25.0	52	1.15
Oregon	32.0	64.5	32.5	102	1.01
Pennsylvania	247.9	373.2	125.3	51	5.84
Rhode Island	24.4	29.4	5.0	20	.46
South Carolina	22.3	78.0	55.7	250	1.22
South Dakota	9.0	17.9	8.9	99	.28
Tennessee	66.7	123.3	56.6	85	1.93
Texas	276.1	357.3	81.2	29	5.59
Utah	7.4	18.5	11.1	150	.29
Vermont	9.4	14.1	4.7	50	.22
Virginia	17.8	152.1	134.3	*754	2.38
Washington	56.8	100.3	43.5	77	1.57
West Virginia	28.1	53.7	25.6	91	.84
Wisconsin	84.6	137.4	52.8	62	2.15
Wyoming	4.7	10.2	5.5	117	.16

[1] Estimated cigarette sales with no smuggling are from ACIR. Assumes all States because they impose no cigarette tax. Detail does not add to total.

*Major cigarette producing States.

VII. Criticisms Expressed of Proposed Bills

Contraband Proposals

There are several general criticisms that have been made of contraband proposals:

(1) Enforcement of a State tax is not a matter of Federal concern; and along with the power to levy excise taxes, the States must accept responsibility for their enforcement.[18] This criticism applies as well to tax equalization approaches.

(2) States are not doing enough to enforce their anti-smuggling laws and these laws are too weak to warrant Federal enforcement of severe criminal panalties.

(3) Contraband enforcement will not be effective. At most, contraband is estimated to reduce smuggling by one-third.[19] It does not really deal with the problem, which is State cigarette tax differentials.

(4) Contraband enforcement will involve Federal officers in excessive intrusion into the law enforcement activities of States and the operations of cigarette manufacturers.

Tax Equalization Proposals

There are several general criticisms that may be made of Federal cigarette tax equalization provisions:

(1) Federal cigarette tax equalization would intrude on State taxing authority. Some bills would deprive the States of a tax they have a right to impose, and would therefore be coercive.[20]

(2) Tax equalization would require smokers in low-tax States to pay higher taxes for what is essentially a problem of a few high-tax States.[21]

(3) Some bills, e.g., H.R. 10066, would impose a tax increase (23 cents a pack) that is claimed to be too large, would hurt the cigarette industry, and be larger than necessary to achieve tax equalization.

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[18] *Report,* p. 9.

[19] *Report,* p. 49 and testimony of the International Association of Chiefs of Police; see part IV of this pamphlet before the Subcommittee on Crime of the Judiciary Committee.

[20] Federal action in the area of State tax equalization is not unprecedented. (See the discussion of the Federal-State estate and the unemployment tax equalization approaches in Part III of this pamphlet.)

[21] However, as James H. Tully, Jr., Commissioner, New York State Department of Taxation and Finance said in a statement submitted to the ACIR, (*Report,* on page 100):

"More important, the 23 states with "serious" or "moderate" problems represent 70 percent of the population of the United States. It is these people who have the problem in lost public services, destruction of legitimate business and increased organized crime."

(4) Some bills, e.g., H.R. 11152 and H.R. 10579, are said to be too redistributive. They would increase the Federal tax and instead of returning all the tax increase money to the State where it was raised would distribute part of it to other States and the Federal Government.

(5) Future use of cigarette taxes as an additional source of State revenue would be foreclosed and States would be cut off from a source of needed revenue.

(6) Complete elimination of State cigarette taxes would make it difficult if not impossible to obtain data on State retail cigarette sales for purposes of Federal payment.

(7) The bills do not require that the States pass through revenue from the Federal Government to their cities to compensate them for the loss of their cigarette taxes under the bills.

VIII. Additional Considerations

State Tax as a Credit Against the Federal Tax

The suggestion has been made that an approach that is more appropriate than that of the tax equalization bills would be for the Federal Government to impose a tax and the States be permitted to receive a credit against this Federal tax for any State cigarette tax they impose (as is done in the estate tax and unemployment tax area). This approach would be intended to force States to raise their tax to the level of the Federal tax, achieving the same result as the Federal tax equalization approach. The difference, however, is that the tax remains a State tax under State control rather than being a Federal tax with distribution of the Federal tax back to the States.

A problem with this approach is that in order to equalize tax rates without any State having a reduction in cigarette tax revenue it would require that the Federal tax be increased by an amount equal to the highest State tax namely, 21 cents per pack.This would be a substantially larger tax increase than the 14 cents per pack provided in H.R. 11152 and 10579. These bills avoid increasing the Federal tax to the highest State rate by using part of the revenue to "buy out" the high tax States to induce them to reduce their cigarette tax rates.

Future Tax Increases

To deal with the State concern about the Federal Government's foreclosure of the State cigarette taxes as a future State revenue source, two types of approaches could be taken:

(1) States could be permitted to increase their tax by as much as, say, 5 cents a pack after 3 years if they elect to participate (otherwise, there would be no limit). This would permit a potential tax differential among States of 8 cents (some States might not impose the 3-cent tax) a pack, which is probably enough to encourage some smuggling.

(2) The Federal tax could be increased from time to time, perhaps a cent every two years or indexed somehow, and the additional amount (about $290 million per one cent increase) divided one-half to the Federal Government and one-half to the States as in H.R. 11152.

Passthrough to Cities

The assumption underlying the tax equalization bills is that since the States were being "held harmless" with respect to their cigarette tax receipts and since cities are creatures of the States, the State would similarly hold harmless cities with cigarette taxes. The bills could, however, require such State hold harmless passthroughs to cities.

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